

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 051

June 27, 1958

BAD DEBT RESERVES: BUILDING AND LOAN ASSOCIATIONS

Syllabus:

A building and loan association will not be permitted to use the reserve method of deducting bad debts where it does not keep adequate records to reflect such reserves or the debits and credits thereto.

Advice is requested as to whether a building and loan association should be permitted to use the reserve method for the deduction of bad debts in a case where the corporation keeps no other account or records in its books to reflect such reserves, or the debits or credits thereto, other than the computation made on the return itself.

Permission to use the reserve method of bad debts rather than a specific charge-off method is within the discretion of the Franchise Tax Board. (Section 24348 of the Bank and Corporation Tax Law). Pursuant to this authority, the Franchise Tax Board gave permission to the building and loan associations to use the reserve method, but with the proviso that "Associations electing the reserve method for bad debts must maintain a proper record in their books of account to clearly reflect the annual debits and credits to the bad debt reserve." When the taxpayer made its election it did so subject to the condition that proper records would be kept. Where records are found not to have been kept it is within the Board's discretion to revoke the permission and disallow the use of the method. It is proper to require a reasonably strict compliance with the instructions; and where the accounts and records do not readily reflect the status of the reserve for state tax purposes, disallowance is in order. If a taxpayer is found to have substantially complied with the requirements so that correct information is readily ascertainable, the deduction may be allowed for past years, subject to the requirement that if the records are not entirely adequate the taxpayer can be required to straighten them out for future purposes.